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Irish Life

INVESTMENT OUTLOOK

2016

Irish Life Investment Managers are part of the Great-West Lifeco group of companies, global leaders in financial services. We have over €52 billion* in assets under management on behalf of our domestic and international clients who trust, believe and invest in our award winning investment capabilities. In return, we aim to deliver class leading service and products to our customers, domestic and international whether retail, corporate or institutional.

*Source: ILIM, correct as at 31/12/2015.

Irish Pensions AWARDS 2015

WINNER
Investment Manager of the Year

The good news is that most economic forecasts point to another year of growth for the global economy in 2016. The bad news is that if the latter half of 2015 and the first few weeks of 2016 are anything to go by, it may be a bumpy, if rising, road ahead.

Thankfully, 2015 was another very successful year for the flagship Irish Life Multi Asset Portfolios (MAPS) funds which passed through €1.4 billion by year end with the broader multi asset portfolio strategies now in excess of €5 billion in assets under management. That confirms Irish Life MAPS as the largest retail multi asset portfolios in Ireland* in terms of assets under management for the second year running.

In this issue of the Investment Outlook, we take stock of the key assets classes (equities, bonds, property and alternatives) and examine what may lie in store for each of them. We also examine how the largest economies in the world are likely to fare in a new uncertain environment where fragile investor confidence and market instability characterise the challenge ahead.

CONTENTS

* Source: Multi Asset Provider Factsheets, correct as at 31/12/2015.

SECTION 1

INTRODUCTION

THE GRAND OLD DUKE OF YORK...

Stock markets rarely incline one to break into song, let alone nursery rhyme, but recent market activity reminded me of the dilemma facing the Grand old Duke of York and his men. When they were up, they were up and when they were down, they were down. So far, so good - everybody knows where they stand. The real question then, and for markets now, is trying to figure out whether they are half way up or only half way down.

CONFIDENCE IS KING...

Investors and forecasters alike are increasingly obsessing over every piece of economic data produced to help them answer that question. The focus was initially on China, then the US, then Oil and more recently European banks. The results have been striking. In the last 12 months we have seen the weakest and most volatile global stock markets for some time driven by unsettled investors trying to interpret a host of conflicting market data, some positive, some negative. The month of January alone was the weakest opening by stock markets on record. Surely that must say something about the data? It does, but the issue here is not just the economic data – it is bigger than that. It is investor confidence and, perhaps predictably, some investors have taken profits from the recent strong stock market run going back several years now to reassess. That is neither a good thing nor a bad thing. Markets are cyclical and reflect not just the quantifiable and rational fundamentals like profits and ratings but also the less quantifiable and potentially irrational things like sentiment and confidence.

THE KEY TO RECOVERY...

When markets are falling, they feel like they will fall forever but that has never actually happened. To prevent it from happening, at least one of two things typically occurs. Either a) economic data recovers and broad investor confidence returns or b) valuations fall to such an extent that long term value buyers recognise the opportunity to make money by investing for the medium/long term and can live with short term volatility. We think both could happen in 2016.

There is no doubt that 2016 will be a challenging year and a departure from the relatively calm markets of recent years but we have never been more committed to supporting you. Let our experience, expertise and award winning investment team support you and your investment opportunities in 2016.

David Haslam
Head of Retail, ILIM

IRISH COMMERCIAL PROPERTY

BUILDING PERFORMANCE AS MARKETS CRUMBLE...

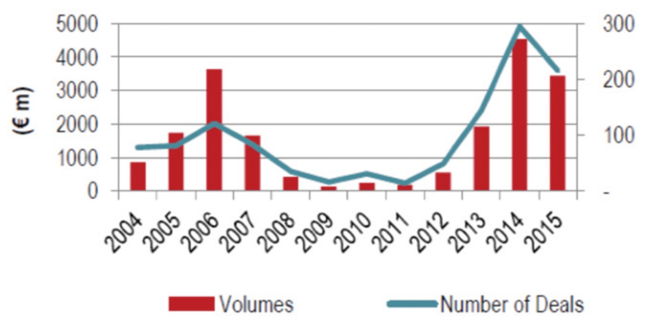
SECTION 2

IRISH COMMERCIAL PROPERTY

ANOTHER EXCELLENT YEAR FOR IRISH PROPERTY INVESTMENT

The Irish property investment market has generated exceptional levels of return and record liquidity over the last three years through the recovery phase of the investment cycle. 2015 delivered - near peak investment transactional activity at €3.4bn, with the weight of buyer activity moving from opportunistic to core type buyers - and excellent total returns exceeding 20%, driven by Dublin office rental growth.

INVESTMENT VOLUMES AND NO. OF DEALS



Source: JLL Ireland

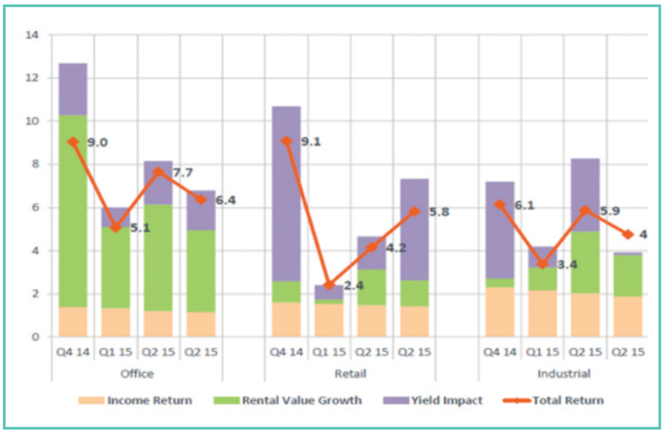
As we move into 2016 the case for investing in Irish investment property as part of a multi asset portfolio remains strong.

Investor demand for prime property yielding assets is set to persist, with the ECB quantitative easing programme destined to keep interest rates low for longer, combined with the relative attraction of Ireland as a recovering growth economy. This is being recognised by a growing cohort of overseas lower risk core style investors, such as Union, Hammerson, DEKA and Starwood REIT, who in addition to domestic institutions and domestic REITs will become of greater significance to the market as the private equity investors look to recycle property through sales over the next few years. These international investors add to liquidity, which is expected to result in a more mature property market that hasn't been the case in previous cycles.

The weight of investment activity over the last 3 years has resulted in significant yield compression across the different sectors of the market. During 2015 the prime office yield decreased by 50bps to 4.50%; the prime retail yield reduced to 3.75%, in anticipation of a recovery in rents from recessionary levels; and the prime industrial yield reduced significantly to 6.0%. Current yield levels are below their long term average but are supported by; a 4% spread over long bond yields, the prospects for further rental growth and the relative attractiveness of Irish property compared to other markets. Limited further yield compression is expected in 2016. Investors are therefore focused on the potential for capital growth from improving rental values, as well as the relatively attractive income return from the sector.

OCCUPIER FUNDAMENTALS DRIVING RETURNS THROUGH THE SECOND PHASE OF THE CYCLE

Throughout 2015, office and retail occupier fundamentals have been the largest driver of capital growth, with Dublin office rental growth leading the way and rental growth emerging in prime retail locations



Source: MSCI IPD

The prime Dublin office rent is now €55 per square foot, from €27 per square foot at the bottom of the market, and is trending upwards. Rental growth has been driven by a lack of availability of office stock in the city centre and a record level of tenant demand, as business service sector employment continues to grow. This is generating opportunities to deliver space into the market through refurbishment of existing buildings and the development of new stock. Irish Life has been particularly successful at adding value through refurbishing existing properties and new acquisitions.

BLOCK 1, IRISH LIFE CENTRE, DUBLIN - REFURBISHMENT COMPLETED

- 38,000 square feet;
- Refurbished and completely re-let to two strong tenants.

There is a significant potential office development pipeline in central Dublin. NAMA has announced plans to commence construction on a number of schemes in the Docklands Special Development Zone, and a number of speculative office schemes commenced in 2015. Over recent months the focus of commercial property market commentators has been the potential for oversupply in the latter part of the decade, as developers react to the current scarcity of Grade A stock in the city.

However, we believe this misses the real story, which is the exceptional level of tenant demand and take up from office occupiers, which exceeded 2 million sq. ft. in 2015, and how the level of tenant demand holds up into the future as new office developments are delivered. We expect development finance availability and pricing, and limited prelet opportunities to be constraints on development supply. At Irish Life we are focused on timely delivery, the primest locations and exceptional environmental quality to mitigate the leasing risk in our new office schemes. Current schemes in train include Hainault House, a new 58,000 sq. ft. scheme on St Stephen's Green.

HAINAULT HOUSE, ST. STEPHEN'S GREEN, DUBLIN - PROPOSED REDEVELOPMENT

- 33,000 square-feet to be replaced with a 58,000 square-foot new office building;
- To be built to a high environmental standard.

The retail environment has seen a strong positive shift in sentiment and activity in 2015. The pickup in the domestic economy, on foot of strong growth in employment, is feeding through to consumer confidence and spend. As a result the outlook for prime Dublin high street retail units, shopping centres and retail parks is strengthening with positive rental growth emerging, particularly on Grafton Street. Prime retail properties are expected to deliver positive rental and capital growth in 2016 as the domestic economic recovery gathers pace. In anticipation, we have invested heavily in prime retail investments, including a number of prime units on Grafton Street and Henry Street.

Hodges Figgis 56-58 Dawson Street Dublin

McDonalds 9-11 Grafton Street Dublin

Clarks 85-86 Grafton Street Dublin

3 Henry Street Dublin

Summary

The cycle is evolving, with the outlook for 2016 remaining positive

Property investment activity in 2016 is set to continue at strong levels but as the bank deleveraging process draws to a close lower sales volumes are expected from that source, however the emerging trend of resales from short term investors and portfolio break up sales, through on and off market transactions, are expected to grow significantly in 2016.

Income return and rental growth are expected to deliver positive returns in 2016. However all investors need to be realistic as to the expectation of future returns from the sector given the exceptional level of return over recent years, and be fully aware of the risks that emerge as the pricing and rental cycles evolve.

Martin O'Reilly
Head of Property, ILIM

EQUITY MARKETS

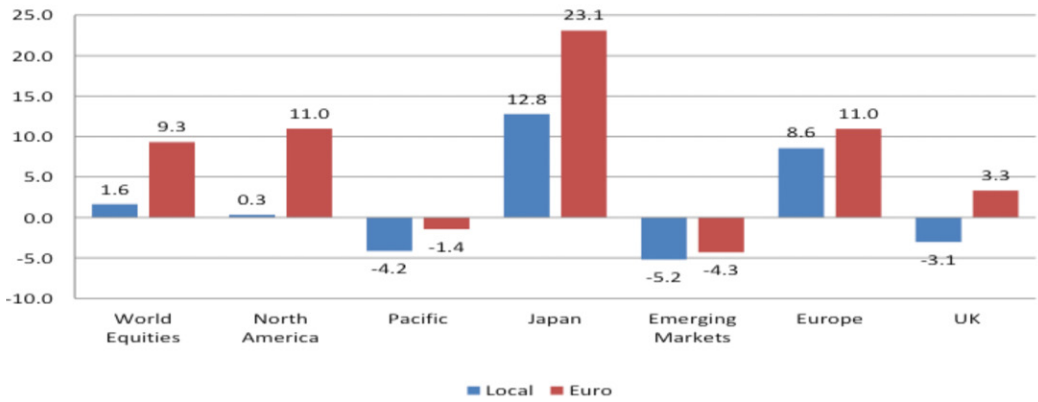
UNDERPINNING PORTFOLIO RETURNS BUT VOLATILE...

EQUITY MARKETS

2015 PERFORMANCE

Returns from equity markets in 2015 were modest in local currency terms although were significantly better in Euro terms. Two of the best performing regions were Japan and Europe, both markets where quantitative easing continues to be implemented. The chart below illustrates returns in various equity markets in 2015. Looking just at the returns however masks the rising levels of volatility which was particularly evident in markets in the second half of 2015.

MARKET RETURN YEAR TO DATE (AS AT 17 DECEMBER 2015)



Source: Factset

The volatility in equity markets and various periods of gains and falls can be seen in the chart below.

Source: FTSE

EQUITIES RISE UNTIL MAY

The old adage of 'sell in May and go away' was quite appropriate in 2015 with markets peaking for the year in late April/May following steady gains in the early months of the year. These were largely driven by the continued accommodative monetary policies being adopted by global central banks. Following the peak in May, equity markets drifted lower through the summer as the Greek crisis played out. At the eleventh hour however, a compromise was reached and a third bailout programme was agreed with commitments from the Greek government that it would implement reforms and programme requirements. This agreement, and the avoidance of a Greek exit from the Euro, calmed market fears and contributed to a rebound in equity markets through July of the year, although on a relative basis they remained very attractive compared to other asset classes such as bonds and cash, given the low levels of yields available on these assets. This also contributed to the positive returns in equities in the earlier part of the year.

CHINA GROWTH CONCERNS

The Greek relief rally proved to be short lived with markets experiencing renewed selling pressure in August related to concerns over the growth outlook in China. While it was generally accepted that growth had slowed in China compared to levels evident pre crisis, concerns over the extent of the slowdown were heightened in early August by a surprise devaluation of the Chinese currency, the Renminbi (Rmb). The currency devaluation was seen by investors as an effort to stimulate exports and boost growth. With China accounting for approx. 15% of the global economy, any increasing risk of a hard landing in the economy was thought likely to have negative repercussions for the global economy. As a result, equity markets fell sharply on rising fears of potential negative contagion to developed economies from slower growth in China and emerging market economies in general.

Equities fell to new lows in late September after the US Federal Reserve (The US Fed) decided not to raise interest rates at its September meeting. The US Fed highlighted that the reason it was not raising rates was because it wanted more time to evaluate the potential threats and impact on the US economy of the recent global economic and financial developments. This, in turn, increased investors' anxieties and fears over the growth outlook in China and contributed to the second leg lower in equities.

OCTOBER RECOVERY

Equity markets recovered again through October and November as economic data in China began to stabilise. Many economic indicators indicated that while growth in China has slowed and is probably lower than official estimates of around 7%, growth is still probably running somewhere close to 6% and thus the economy is not slowing to levels of 4% or less as feared by investors through August and September. Better economic releases in developed markets, particularly stronger US labour market data and improving global Purchasing Managers Index (PMI) readings also eased concerns over any potential negative contagion to the global economy from slower growth in emerging markets.

The US FED were more upbeat of their assessment of global markets in October This gave a welcome boost to investor confidence on the macro environment and contributed to the recovery in equity markets in the fourth quarter.

Meanwhile increasing expectations of additional monetary stimulus from the ECB following comments that risks to its inflation forecasts were to the downside, also supported equities.

DECEMBER VOLATILITY

Equity markets remained volatile in December. In the run up to the ECB meeting in early December, markets continued to rally on expectations of significant further easing measures from the ECB. However, the ECB disappointed investors and as a result equity markets experienced renewed selling pressure.

On December 16th, the US Fed raised the Fed funds rate by 0.25%, seven years exactly after lowering interest rates to historic lows and over nine years after the last interest rate rise in 2006 Equity markets reacted positively to the Fed's upbeat view of the economic backdrop and their indication that interest rates will not be raised aggressively with the pace of rises likely to be slower than in previous cycles.

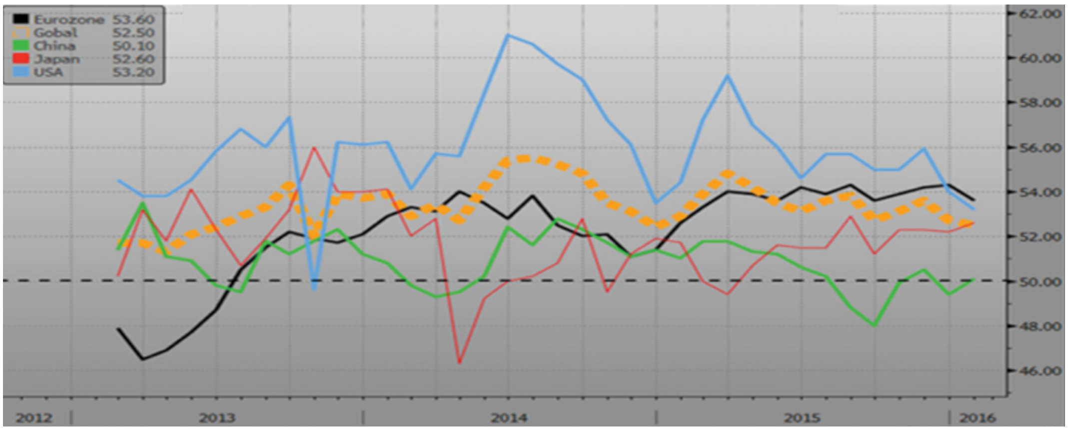
EQUITY MARKET OUTLOOK

So, where are global equities likely to go from here? We believe equities still provide upside, supported by a number of factors although returns could be more modest compared to those experienced since the trough in markets in 2009 or the more broad based gains since 2012. Furthermore, there will likely be reduced currency benefits to a Euro based investor from a falling Euro relative to the dollar or sterling. However while the overall trend in equities is expected to remain upwards for the time being, the greater volatility which has been a feature in markets over the last fifteen months is unlikely to disappear.

ECONOMIC BACKDROP

The global economy has remained in a low growth cycle since emerging from the Great Recession at the end of the financial crisis with growth remaining in a tight range of 2.5/3.0%. While there have been numerous instances of mid cycle growth concerns, the most recent being related to concerns over growth in China, the global economy has weathered these and maintained a steady pace of growth over the last number of years.

COMPOSITE PMI (GLOBAL, EUROZONE, CHINA,JAPAN)



Source: Bloomberg

So, while global growth remains below the levels evident pre-crisis, growth remains solid and for 2016 should remain in the 2.5/3.0% range it has been in over recent years. While concerns regarding the growth outlook in China persist, investors have been somewhat reassured by the stability in key Chinese indicators such as the ongoing improvement in retail sales which are running at relatively strong levels of 11.2% y/y. This suggests growth remains well underpinned and the economy should not experience a hard landing which could derail the global economy. However, sentiment can dislocate market performance from fundamentals over short periods and ongoing selling pressures may force markets lower before a recovery emerges.

CENTRAL BANKS SUPPORT

Accommodative central bank policy has been supportive of global economies and equity markets in recent years. The ECB and Bank of Japan are currently undertaking asset purchase programmes of €60bn per month and Y80trn pa respectively. In early December the ECB extended its asset purchases out until at least March 2017 or until such time as inflation gets back to the ECB's 2% target on a sustainable basis. It also reduced further the deposit rate by 0.1 % to -0.3%. While these measures were actually less than had been expected by investors, they still represent a significant increase in the level of policy accommodation and there is a possibility that the ECB could announce additional measures in 2016 if inflation seems likely to miss forecasts.

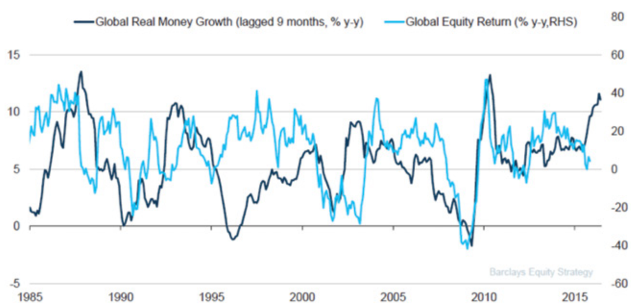
The ECB has forecast headline inflation across the Eurozone of 1.0% in 2016.The most recent reading measures is 0.2% y/y. While inflation is expected to rise in coming months due to the base effects of oil price declines in late 2014 falling out of calculations, inflationary pressures remain subdued due to significant output gaps in Eurozone economies, renewed weakness in the oil price towards the end of 2015 and deflationary pressures from weaker currencies in emerging markets. Additional policy measures could consist of increases to the level of monthly purchases, a further extension of purchases beyond March 2017 or further reductions in the deposit rate.

In the US, while the Fed has just begun to tighten rates, it has indicated the pace of further rate rises will be gradual and policy will remain accommodative relative to history with rates remaining significantly lower than in previous cycles. The Bank of England has similarly suggested rates will remain below historic levels when it begins to raise rates with current expectations for that to happen pushing out to 2018.

Overall, monetary policy is expected to remain accommodative with additional measures possible from the ECB and Bank of Japan, although the probability is lower in the case of the Bank of Japan. In regions where interest rates are rising; policy will remain relatively accommodative compared to history.

Historically global equity returns are quite closely correlated with global monetary growth as highlighted below. More recently global equity returns have lagged the continued strong improvement in monetary metrics and based on the historic relationship between the two, equities should rise from current levels.

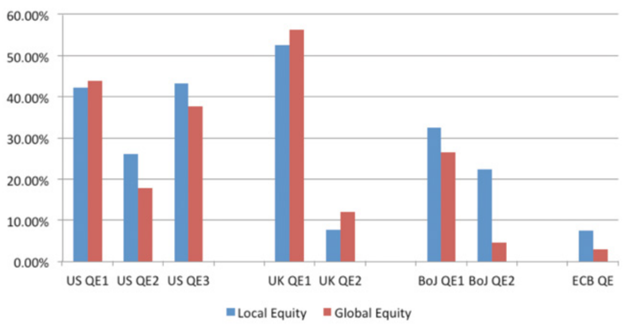
EQUITY MARKETS AND MONETARY GROWTH



Source: Barclays Research

Equity markets have clearly benefited in recent years from the monetary stimulus and asset purchase programmes announced by global central banks. The chart below highlights the equity market move during the time when asset purchase or Quantitative Easing (QE) programmes have been implemented both in the local markets where the programmes have occurred and in global equities. On average, even allowing for the lower returns in markets in 2015 due to the falls associated with concerns related to growth in China, local equity markets have risen on average by 29% and global equity markets by 25% while these QE programmes have been implemented.

EQUITY MARKET MOVES DURING QE



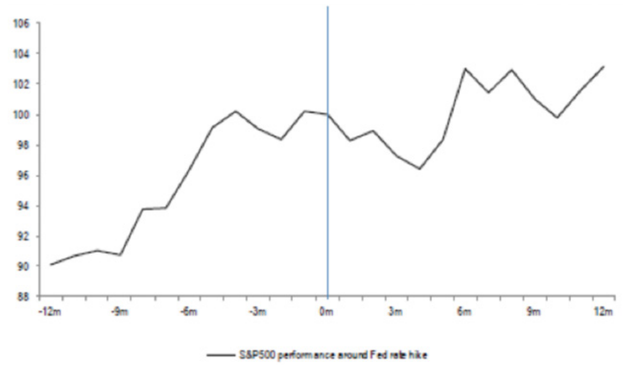
Source: ILIM

EQUITY MARKET PERFORMANCE AROUND RATE RISES

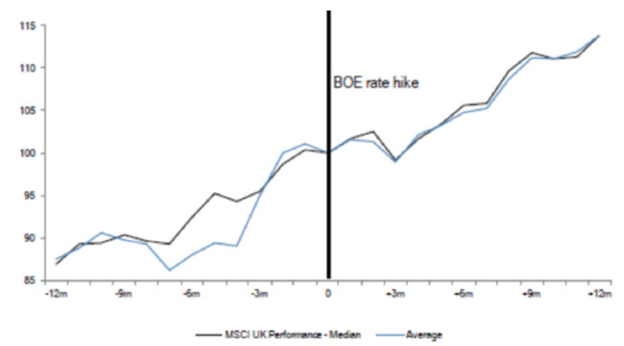
There have been concerns among some investors that the beginning of rate rises in the US and possibly in the UK during 2017 could be negative for equity markets. Historically however in the twelve months following the beginning of rate rises in either the US or UK, equity markets have generally continued to rise.

The charts below show what equities in the US and UK have done on average twelve months before and twelve months after the first rate rise since the early 1970's.

US EQUITY PERFORMANCE AROUND RATE RISE



UK EQUITY MARKET PERFORMANCE AROUND RATE RISE



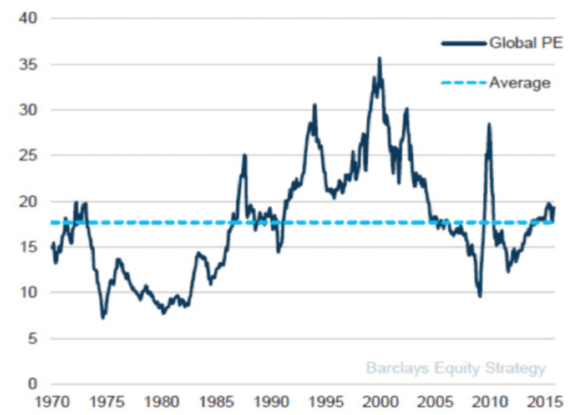
Source: JP Morgan December 2015

The vertical line in each graph represents the timing of the first rate rise in each region. To the left of the line indicates how equities performed on average in the twelve months prior to the first rate rise and to the right how they performed on average twelve months after the rate rise.

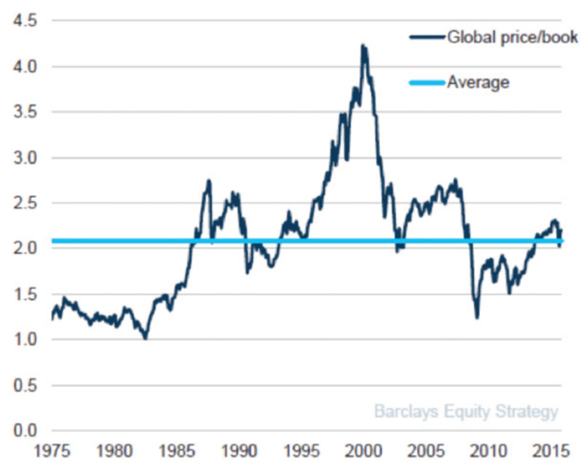
EQUITY VALUATIONS

Following the gains in equity markets over the last number of years, on the basis of a number of valuation metrics, equities are no longer cheap in absolute terms having risen close to fair value on many measures as shown below.

GLOBAL EQUITY PRICE/EARNINGS MULTIPLE



GLOBAL EQUITY P/BOOK MULTIPLE



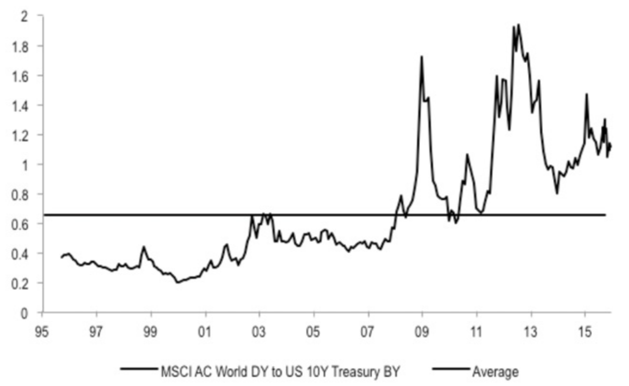
Source: Barclays Research

We believe that while equities are around fair value on a p/e basis, they can still rise by c.7% in 2016, in line with consensus global earnings growth forecasts.,

EQUITY RELATIVE VALUATIONS

The strongest valuation case for equities is a relative one. Global equities continue to remain extremely attractive versus bonds and cash given the relatively low yields available on these assets. The chart below looks at equity valuations relative to bonds. Currently the relative yield on equities remains attractive compared to the yield on bonds and is significantly above the average relative yield between the two assets over the long term, highlighting the relative attractiveness of equities versus bonds.

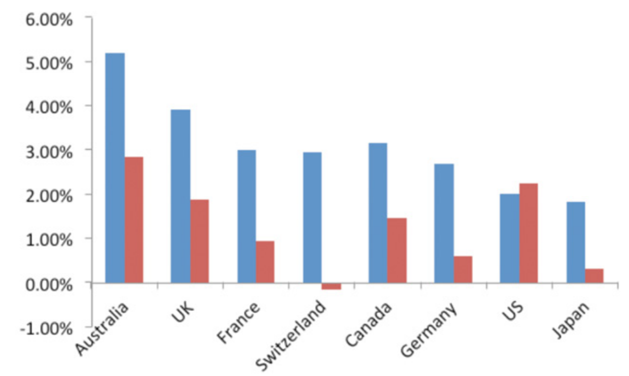
GLOBAL EQUITY DIVIDEND YIELD V'S BOND YIELDS



Source: JP Morgan

The chart below highlights on a regional basis the relative attractiveness of yields available in equities compared to bonds by showing the equity dividend yield in various markets compared to the current yield on the benchmark 10 year sovereign bond in each region. With the exception of the US, the yield available in the equity market significantly exceeds the yield which can be obtained from holding the benchmark bond in each market. If the search for yield continues, which has been a key investment theme for investors in the low yield environment, this favours equities at the expense of sovereign bonds given the better yields available in equities.

REGIONAL EQUITY DIVIDEND YIELD V'S 10 YEAR BOND YIELDS



Source: Factset

INVESTOR POSITIONING AND SENTIMENT

While investors in general are positive on equities with a net 42% of institutional investors overweight equities according to the BofA Merrill Lynch investor survey, this is not at extreme levels where a net 60/70% of investors how been overweight at previous peaks of positive sentiment towards equities. This suggests that investor's overweight position in equities has scope to rise further. Also in the survey, institutional cash levels are currently indicated as being above average at 5.2% and typically in the past, cash levels of 4.5% or above have been associated with positive equity returns in the following months as investors put this cash to work in the market.

In the US, individual investors holdings in equities are estimated to have remained more or less the same over the last couple of years and are not viewed as being extremely high or low for the current stage in the cycle. Recent analysis of hedge fund equity weightings indicate they are currently generally in line with long run averages and thus hedge fund managers, similar to long only institutional investors, have scope to increase their weighting in equities as do individual investors in the US.

The level of analyst sentiment regarding stocks is often a good contrarian indicator for equity markets. Currently the level of optimism among company analyst towards stocks is relatively low with less than 45% of analyst recommendations on stocks being a 'buy' compared to an average of closer to 50% and prior peaks of 60%. Historically when analyst optimism is this low, equities tend to rally.

RISKS

While our central view on the outlook for equities is positive, there are a number of potential risks which could give rise to difficulties in equity markets in 2016.

LARGER AND FASTER INTEREST RATE RISES

Currently investors' expectations regarding the pace of upcoming US interest rises are more benign than outlined in the Fed's own estimates of the future level of interest rates. If the rate tightening cycle turned out to be more rapid and higher than even currently outlined by the Fed due to a rise in inflation above current expectations because of a pick-up in wage inflation or a sharp rebound in oil and commodity prices, equities could also be negatively impacted in such a scenario.

CORPORATE BOND SPREADS

Corporate bond yield spreads have increased in 2015, particularly in the high yield space due to concerns over the impact of lower oil prices on the energy sector which makes up approx. 20% of high yield bond benchmarks in the US. Rising yield spreads in the past have often been a lead indicator of deterioration in underlying economic and corporate financial fundamentals and if it were to continue could be an indication of future declines in equity prices.

CHINA AND EMERGING MARKET GROWTH

There is still a risk that growth could deteriorate more quickly than anticipated in China and emerging markets in general with negative consequences for the global economy and equity markets. Debt levels remain relatively high across many emerging markets and with commodity prices remaining under pressure. Investment and capital flows are slowing and in many cases reversing, due to weaker currencies and rate rises in the US hence the risks surrounding the growth outlook in emerging market economies remain.

POLITICAL ISSUES

In Europe, political tensions remain evident with an upsurge in support for both extreme right and left wing anti-European political groupings. The recent migrant issue highlighted the political strains across Europe and if these divisions become more exposed and are exacerbated, they could threaten the European/EU integration process. Most notable in this regard is the UK referendum on EU membership which could be held in the first half of 2016 and is likely to give rise to uncertainty in the run up to and aftermath of the poll, depending on the outcome.

POLICY UNCERTAINTY

Following the December ECB meeting it became apparent that divisions were emerging among council members and that there was no longer unanimity and a general consensus regarding the appropriate monetary policies to be adopted. If these divisions were to grow then monetary policy in Europe may become more uncertain and less accommodative with negative consequences for equities.

TERRORISM

To date rising terrorist threats have not had any meaningful long term impact on sentiment and activity levels but could do so if attacks were to escalate

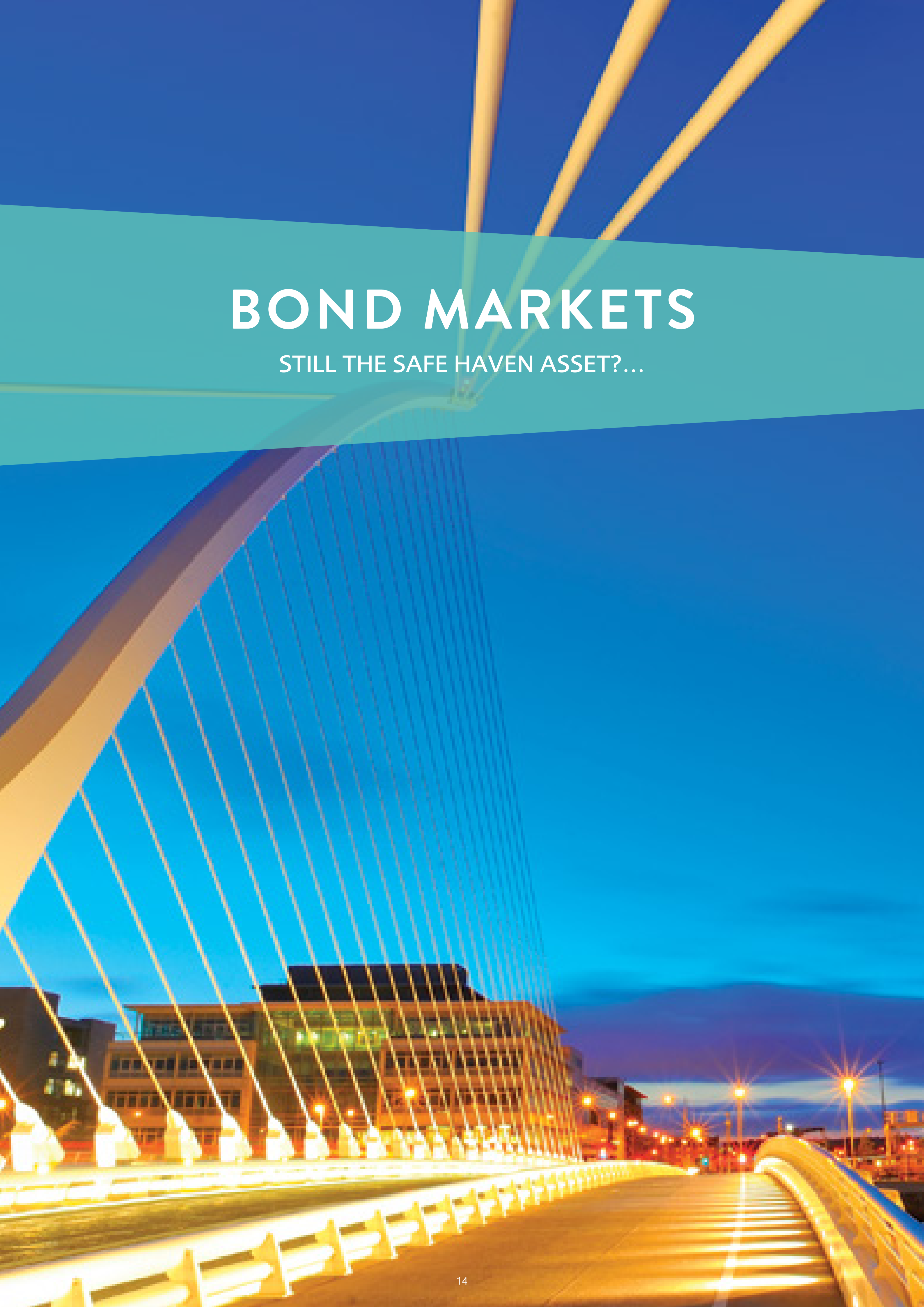
Summary

Overall, we maintain a positive outlook on equities although expect only modest single digit returns in local currency terms in 2016. Upside is capped by absolute valuations no longer looking cheap but instead being around fair value and earnings growth being modest over the next twelve months. The scope for returns on international equity holdings being boosted by further significant falls in the Euro is also more limited given the already large fall in the Euro over the last eighteen months. Our central case is that equities will rise in 2016 for the reasons outlined earlier, in particular due to ongoing accommodative global monetary policy, extremely attractive equity valuations on a relative basis compared to other assets, continued positive global economic growth and a positive earnings growth backdrop. Nevertheless, if there are risks to our central case of single digit returns, it is probably easier to identify more potential negative rather than positive surprises occurring in 2016. As a result, as the year progresses and issues arise, the increased volatility which has been evident in equity markets since the second half of 2014 is likely to remain a feature in 2016 but this in itself could provide opportunities to investors over the course of the year.

Lenny McLoughlin
Chief Economist, ILIM

BOND MARKETS

STILL THE SAFE HAVEN ASSET?...



BOND MARKETS

FIXED INCOME MARKETS - 2015 REVIEW

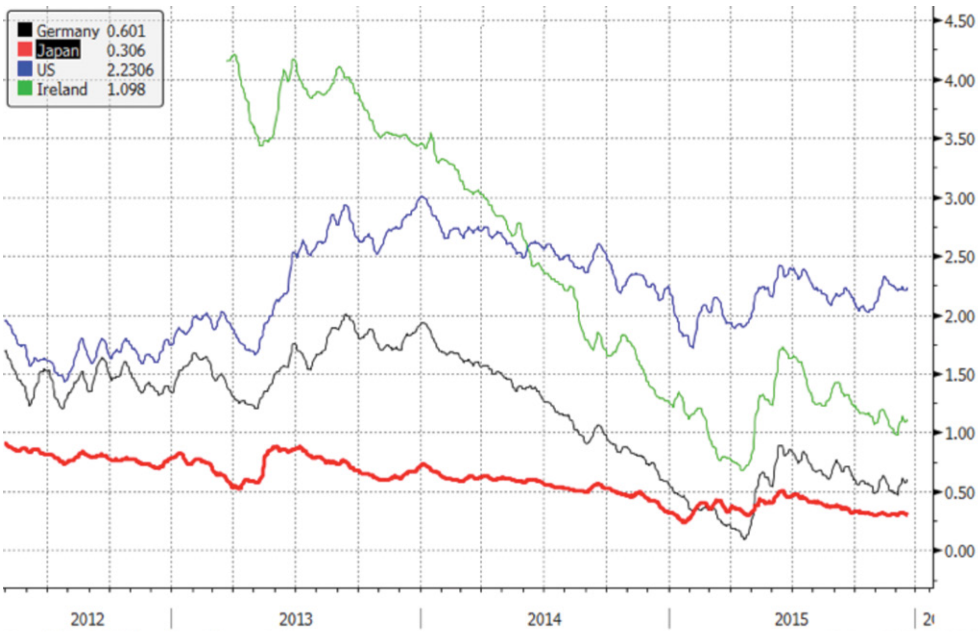
After the strong returns of recent years, bond markets showed a more restrained return in 2015 with the Merrill Lynch Eurozone Government bond index posting a return of 1.5% (to 15/12/15)

The early 2015 expectation of globally stronger GDP growth and higher inflation had resulted in forecasts of the US Federal Reserve starting to hike interest rates from mid-year on with the Bank of England following hot on the heels of the Fed. At the same time the ECB and BOJ were to maintain their supportive monetary stances partly compensating for US and UK. However, by mid-year it became clear that weaker than expected growth in China and Emerging markets had become a drag on global GDP growth. At the same time a devaluation of the Chinese currency and weak emerging market currencies resulted in an export of deflation from these countries to the Developed Market countries.

With GDP growth below forecasts and inflation hovering at or below zero the US Federal Reserve opted to postpone rate hikes, while in the Eurozone the ECB had to extend its QE program by a further 6 months and also cut the deposit rate to minus 0.3%. Weakness in the Eurozone was further compounded by the early Summer Greek crisis and uncertainty from the large amount of migrants flowing into mainland Europe.

As a result bond yields, despite some intra year volatility, are back or below levels seen at the end of 2014. The graph below shows the 10 year Government bond yield for Germany, US, Japan and Ireland.

10 YEAR BENCHMARK BOND YIELDS



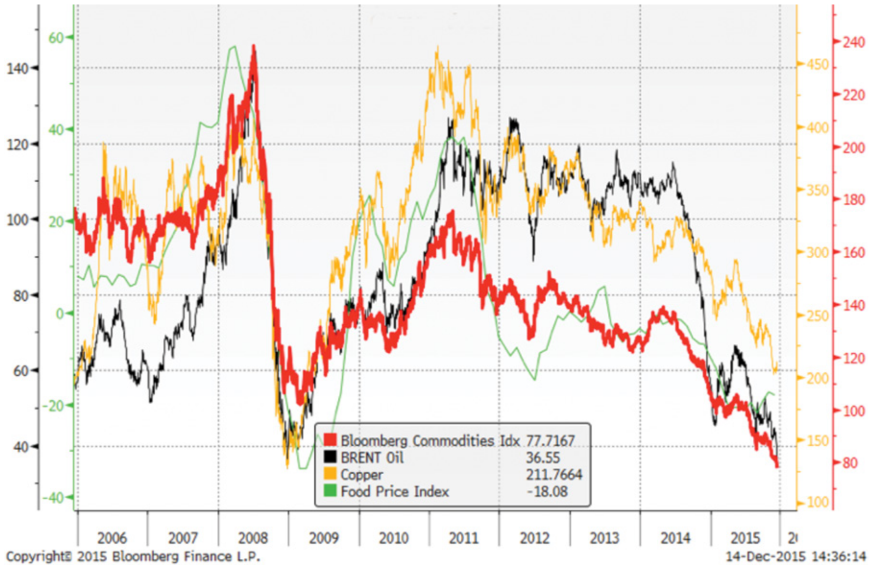
2016 FIXED INCOME OUTLOOK

The fixed income outlook for 2016 will depend on how growth and inflation will develop for major countries over the coming months. The table shows consensus forecasts for 2016 and 2017:

Economic forecasts (2016/17)	GDP (%)	Inflation (%)	unemployment
USA	2.5/2.5	1.8/2.2	4.8/4.6
Eurozone	1.7/1.7	1.1/1.5	10.5/10.1
Japan	1.1/0.7	0.8/2.0	3.2/3.1
China	6.5/6.3	1.8/2.0	4.1/4.2
World	3.3/3.5	3.2/3.5	n.a.

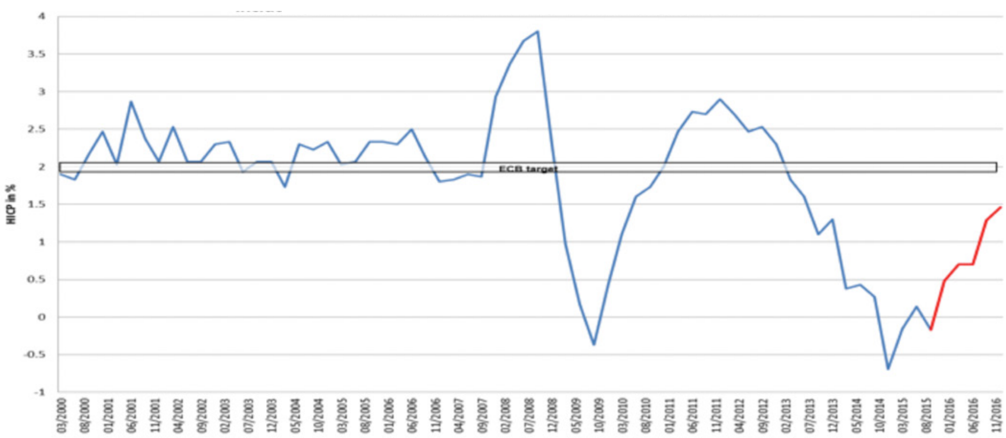
As shown GDP growth is expected to pick up moderately, while 2016 inflation forecasts below 2% will keep Central Banks on their toes. With commodity prices still in the doldrums it will be difficult to see any meaningful uptick in inflation in the coming months unless overproduction – especially in the oil sector - will be reduced in a meaningful way.

COMMODITIES



Nevertheless most developed countries will see an uptick in headline inflation from base effects in the coming months. On a year on year basis commodity inflation will pick up in the coming months as we compare against the low prices of early 2015. However, with commodities at new lows at the end of 2015 the effect will only be marginal and not enough to result in a change of course for Central Banks. The graph shows the experienced Eurozone inflation and forecasts for 2016 assuming an oil price of about $50 per barrel. Even with base effects Eurozone inflation will stay below the ECB's stated target of 2% for 2016 and 2017.

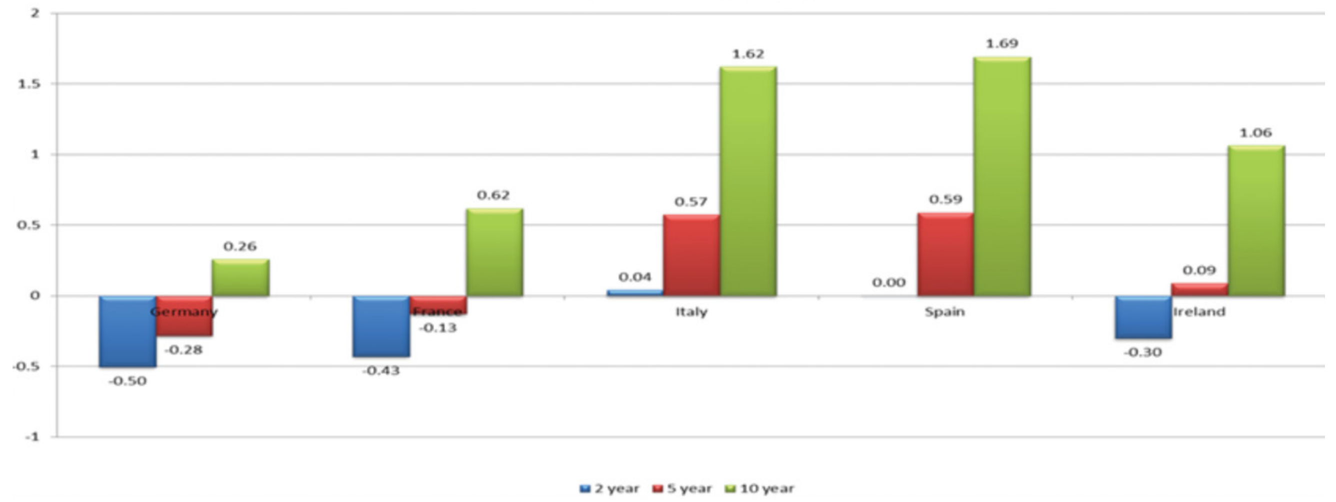
EUROZONE HICP (INFLATION) INCLUDING FORECAST FOR Q4 2015-2016



Source: Barclays

After its initial rate hike in December 2015 the US Federal Reserve will gradually hike interest rates in 2016, but against the weak economic background will be hard driven to reach 1% by end 2016. With the ECB already committed to extending QE into March 2017 a large divergence will develop between the 2 Central Banks. With the help of the ECB's QE Eurozone bond yields are expected to remain low for the coming year. The graph below shows the current bond yields for Eurozone countries.

EUROZONE BOND YIELDS



Source: Bloomberg

Summary

Given that the ECB discount rate is already at -0.3% short dated bond yields are expected to remain in negative territory with ECB purchases maintaining downward yield pressure on maturities out to 30 years. Longer dated bond yields are closely linked to inflation and will experience some upward pressure into rising headline inflation data. Overall we expect a steeper yield curve in 2016 with returns for the Merrill Lynch Eurozone Government all maturity bond index between zero and minus 2% especially as the starting index yield for 2016 will be at a very low 0.6% compared to 2015 of 0.9%.

Max Plapp
Head of Bonds, ILIM

ALTERNATIVES

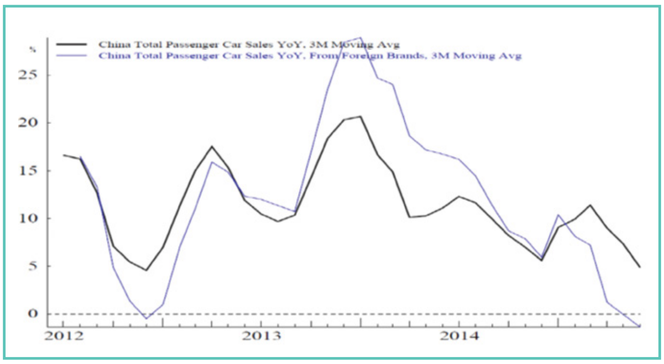
PROVIDING VITAL PORTFOLIO DIVERSIFICATION ...

SECTION 5

ALTERNATIVES

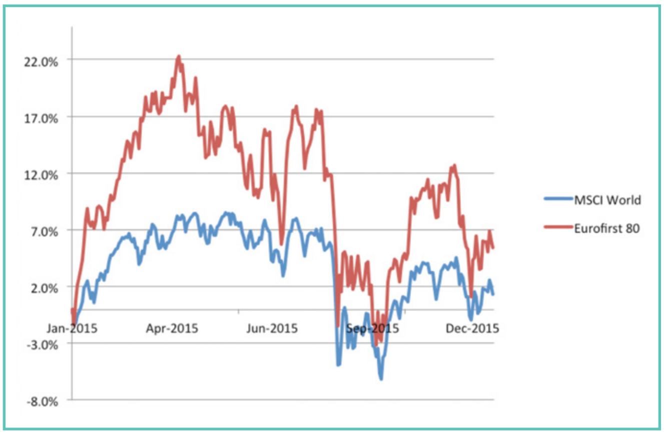
Alternative investments can provide significant diversification within a portfolio as their returns typically have a low correlation to traditional asset classes i.e. equities, bonds, property or cash. Even where Alternative managers invest in traditional assets, they can do so in a non-traditional way to achieve the same lowly correlated returns.

The nature of alternative investments means that there is a very broad range of strategy types available to the managers and investors alike. Indeed, even within a given investment strategy there are many ways in which to invest with fund managers often taking very different approaches given the breadth of options available. One such example would be within the broad category of global opportunity funds, where fund manager expertise and experience can be based on individual sectors, like financials, or even geographies like Asia or North America. However, what they have in common are their trading approaches which are based on the movement of macroeconomic variables such as interest rates, trends in commodity and currency markets. Managers analyse the macroeconomic environment and make 'top-down' allocations based on how they see economic factors driving future growth. Return streams are based extensively on the skill of the managers and tends to be lowly correlated to traditional market exposures. An example of a trade in this type of strategy could be a long position in Chinese car manufacturers coupled with a short position in foreign manufacturers. The logic for this would be that car manufacturers in China will outperform their European counterparts over a period of time. This is known as a 'pair trade', as there are two variables. Interestingly, neither trade needs to go up to be profitable; it is just about one position outperforming the other!



Source: Bloomberg. China Association of Automobile Manufactures

Another example could be taking a long position on European stocks in the belief that they will outperform in relation to global stocks. A corresponding short position is then taken in a global equity index. Once again, performance is not driven by whether markets go up or down but rather by the relative performance of European stocks versus Global stocks.

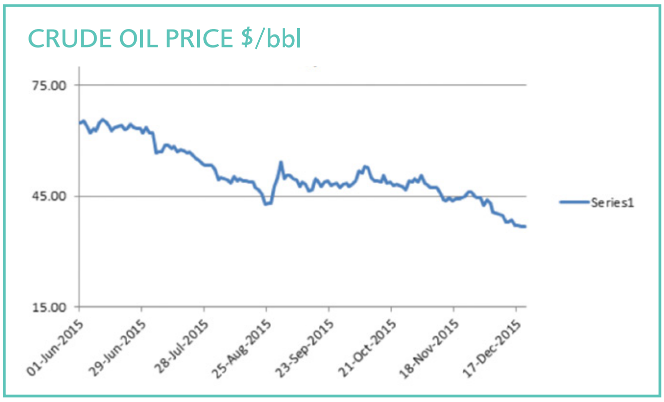


Source: ILIM

As the global macro environment continues to change rapidly there is increasing scope for managers to profit from a wider range of opportunities in this strategy.

Trend following strategies are also very popular within the alternative investments space. Fund managers follow trends in the markets using momentum based strategies. The basic philosophy is that prices tend to trend upwards or downwards over time i.e. they follow a certain direction which is not random. These strategies attempt to take advantage of these market trends by observing the current direction and volatility and using this to decide whether to buy or sell. Strategies are implemented using futures contracts and other derivatives and they trade across a very broad range of markets including equity indices, commodities, bond markets and short term interest rates.

These types of strategies were very much in evidence over the course of 2015, where managers were able to benefit from the volatility in commodity prices and in particular, oil prices. As shown in the chart below, the price of oil fell steadily through the year with very few changes in direction. This is an ideal market environment for trend following systems and illustrates how they can make money when a market is rising or in the case of oil, falling.

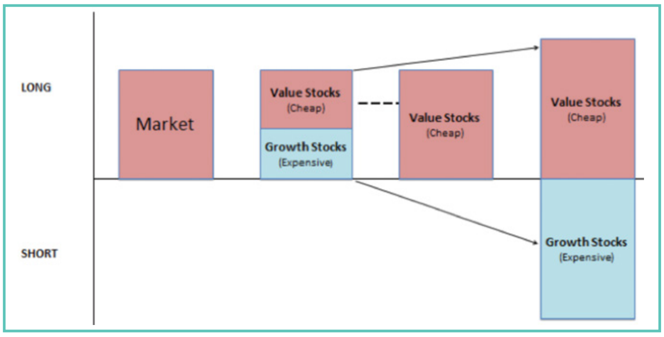


Source: ILIM

However, not all trend following strategies are implemented in the same way which in turn means they can have very different investment returns. This was the case in 2015 when performance varied widely depending on the strategy implemented by individual funds, the timing of their trading and, of course, whether they were right or wrong about a trend. Our view is that trend followers form an important part of an alternative portfolios and one that we see as important going into 2016.

Alternative Market Returns are another strategy type that has become increasingly popular and prominent. They seek to create diversification benefits for investors by targeting particular alternative investment styles across a range of asset classes. Examples of styles targeted by funds are Value, Momentum and Defensive. The concept of these styles has been well understood for a number of decades and the return potential of these styles or 'alternative premia' has been the focus of much academic research. The underpinning of the philosophy is that many hedge funds for some time were largely generating more market type returns rather than skill based returns. These market type returns can be captured in a systematic way without paying high, skill-based fees.

The following chart illustrates how these alternative premias are accessed. Stocks can be broadly split into Value and Growth Stocks. It can be demonstrated that over a long period of time value will outperform growth. Alternative premia strategies benefit by going long (buying) value stocks and going short (selling) growth stocks.

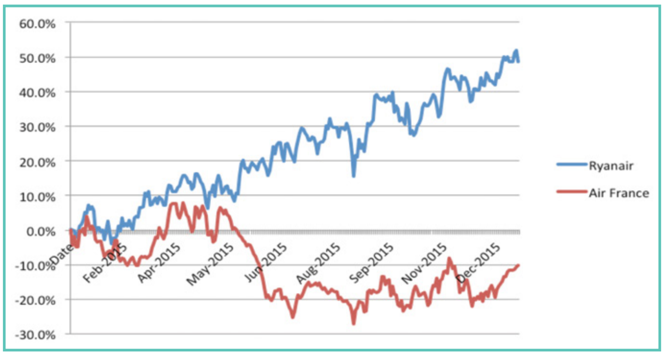


Source: ILIM

This value bias is evident across other markets including bonds and commodities as well as equities. The timing of when these different alternative premia perform in various markets is different. It is therefore possible to combine them to deliver a strong uncorrelated performance.

In 2015 the benefits of alternative premia strategies were evident in a particularly volatile period for equities during August and September and are an important strategy for retail alternatives investors.

Equity long/short strategies are perhaps the most common and best known strategies. This is where a strategy takes long and short positions in certain equities and equity derivatives in the hopes of profiting from gains and/or losses in prices. Long/short equity managers aim to buy equities which they deem to be undervalued, and short equities which they feel are overpriced or are likely to encounter difficulties in the coming months or years. Depending on the strategy used, a manager may short an entire equity index to hedge or offset a particular long position. The example below shows the performance of Ryanair and Air France in 2015. If an equity long/short manager was long Ryanair and short Air France they would earn the difference in performance of these two stocks during the period, which was 53%.



Source: ILIM

Summary

There are a large range of strategies that can be employed within this broad strategy type. Within the hedge fund universe, this strategy type comprises 29% of total capital invested. In general, the strategy performed positively in 2015 and is generally a core component of alternative portfolios.

ILIM are firm believers in a multi-manager approach which we see as an effective means of gaining access to world class expertise in these, and other alternative strategy types. The reduction of single-manager risk and the possibility of achieving higher returns from a broad investment universe is appealing to investors. A portfolio managed to reflect correlation between funds and strategies helps increase diversification benefits and reduce overall exposure to particular market sectors and asset types. For these reasons, we think an allocation to alternative strategies and managers is essential in any multi asset portfolio.

Peter Haran
Head of Alternatives, ILIM

INDEX PERFORMANCES AND MARKET DATA

INDEX PERFORMANCES AND MARKET DATA

Equity Markets (%) (in Local Currency)	2011	2012	2013	2014	2015	2016 YTD (to 29/01)
ISEQ Overall Return	2.6	20.5	35.8	16.8	33.6	-8.4
FTSE 100 TR	-2.2	10.0	18.7	0.7	-1.3	-2.5
Euro Stoxx 50 TR	-14.1	18.1	21.5	4.0	6.4	-6.7
S&P 500 TR	2.1	16.0	32.4	13.7	1.4	-5.0
Nasdaq Composite	-1.8	15.9	38.3	13.4	5.7	-7.8
Nikkei 225	-17.3	22.9	56.7	7.1	9.1	-8.0
MSCI Emerging Markets	-14.9	13.9	0.9	2.6	-8.0	-5.3
MSCI World	-7.6	13.1	26.2	7.7	0.2	-5.5

Source: Moneymate

Sovereign 10yr Bond Yields (%)	2011	2012	2013	2014	2015	2016 YTD
US	1.9	1.7	3.0	2.2	2.2	1.9
German	1.8	1.4	1.9	0.5	0.6	0.3
UK	2.0	1.9	3.0	1.9	1.8	1.6
Japan	1.0	0.7	0.7	0.3	0.2	0.0
Ireland	8.4	4.5	3.4	1.3	1.1	0.8
Italy	7.1	4.6	4.1	2.1	1.6	1.4
Greece	31.7	12.7	8.2	9.6	7.9	9.1
Portugal	13.4	6.9	6.1	2.7	2.5	2.8
Spain	5.1	5.4	4.1	1.6	1.7	1.5

Source: Bloomberg

Central Bank Rates (%)	2011	2012	2013	2014	2015	2016 YTD
ECB	1	0.75	0.25	0.05	0.05	0.05
Bank of England	0.5	0.5	0.25	0.50	0.50	0.50
US Federal Reserve	0.25	0.25	0.25	0.25	0.50	0.50

Source: Bloomberg

Foreign Exchange Rates	2011	2012	2013	2014	2015	2016 YTD
Euro/Dollar (€/$)	1.30	1.31	1.37	1.21	1.09	1.08
Euro/Sterling (€/£)	0.83	0.81	0.83	0.78	0.75	0.76
Sterling/Dollar (£/$)	1.55	1.61	1.65	1.56	1.46	1.43

Source: Bloomberg

IPD All Property Return	2010	2011	2012	2013	2014	2015
Ireland	-2.4	-2.4	3.1	12.7	40.1	20.2 (to end of Q3)
UK	14.5	8.1	2.7	10.7	17.8	9.9 (to end of Q3)
US	14.8	14.5	5.3	11.4	11.2	7.9 (to end of Q3)

Source: IPD

Warning: Past performance is not a reliable guide to future performance

* Information correct as at 29/01/2016

** Equity market returns are total returns

DISCLOSURE STATEMENT

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Any comments on specific stocks are intended as an objective, independent view in relation to that stock generally, and not in relation to its suitability to any specific person.

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Warning: Investments may go down as well as up.

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NOTES

NOTES

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